No. 2825

IN THE

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE NINTH CIRCUIT

NATIONAL SURETY COMPANY,
Plaintiff in Error

vs.

COUNTY OF LINCOLN,
Defendant in Error

PETITION FOR REHEARING

Upon Writ of Error to the United States District Court of the District of Montana.

OREGON PRINTING CO., PORTLAND, OREGON

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Counsel's certificate in original

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We ask the indulgence of the Court to present the argument hereinafter set out because as we read the opinion in the case the following grounds of argument are not fully disposed of thereby, and the argument hereinafter set out convinces us beyond fair debate that the case as finally decided should adopt as controlling the principles hereinafter referred to.

APPROVAL OF PLANS AND SPECIFICATIONS

With regard to the proviso in the contract of December 18, 1911 (p. 66 Transcript), to the effect:

> "It is further agreed and understood by and between the parties hereto that this contract shall not take effect until the War Department of the United States has approved the plans and specifications and granted permission for the construction of said bridge."

We contend that under this provision, it was an agreement that the plans and specifications must be approved for use at this particular place before the contract so far as the surety was concerned would become effective. We also contended that the burden of proving compliance with this provision was upon the County for two reasons:

(a) That otherwise the bridge would be an unlawful structure.

(b) That the provision is a material part of the contract.

And consequently that the Surety would not be bound unless it was shown that the bridge, concerning which suit was brought, was one built upon plans and specifications approved by the War Department.

The opinion in the case proceeds upon the ground that the contract having been performed, it will be presumed that this consent was obtained, as it was necessary to a lawful construction, and that there is no evidence that the Kootenai River was a navigable stream.

Your Honors will see that our contention is to the effect that this provision separate and apart from any question of nuisance was a provision which had it been complied with would have made a material difference to the Surety. The question as to the necessity of obtaining the approval of a third person before a contract becomes effective is a different question than the one of whether or not the bridge if constructed without such approval is a nuisance.

Let us suppose that this contract provided that it should not become effective until the plans and specifications had been approved by John Brown of London, England. Manifestly the parties would have a right to make such a contract and to so condition it; and then let us suppose that John Brown was actually disregarded by both the County and the Contractor. The Surety's obligation is, of course, fixed by the contract and its principal

cannot waive the Surety's rights nor increase them. It would not be incumbent upon the Court to inquire as to why the Surety was willing to guarantee a contract to be performed upon plans approved by John Brown. It is enough that that is the contract which the Surety did guarantee. The fact that the War Department of the United States is specified instead of John Brown does not alter the meaning of the plain words of this contract nor give the principal any greater right to by his conduct waive the rights of the Surety. If the County and the Bridge Company did erect this bridge without obtaining the approval of the War Department, we take it that it would not matter whether it was the County or the Bridge Company who was responsible for this neglect. The duty certainly was upon the County in face of the plain words of this contract to know whether this provision was being complied with. It is a fact that if the complaint alleged or the proof showed that the contractor had surreptitiously or by imposition upon the County procured the County to allow it to build this bridge without obtaining this approval, then, of course, the County could not be charged with the default of the contractor, but where the bald provision is pleaded and no allegation made that it was waived or performed, it seems to us that this Court is not concerned with the question of who was at fault in the failure to

comply with this provision of the contract. The most that is claimed is that it was equally the duty of the County and the Bridge Company if not more the duty of the Bridge Company. Well, suppose it was the duty of the Bridge Company and the Bridge Company by and with the action of the County erected this bridge and the approval was not had. Would this Court establish then as a principle of law that the Surety is liable notwithstanding? In nearly every case where a change or departure has been made from the contract of suretyship, you will find that the principal of the bond is the one who actually instigated the change or departure. This is always true as to advance payments and nearly always true as to changes in character of work, and if Your Honors are settling the law as being that the Surety is liable if its principal requires or obtains a default or breach upon the part of the obligee, there is no place to stop.

It has always seemed to us that this case required a decision upon two questions: First, whether this provision of the contract created a valid condition; second, if so, can a plaintiff recover without pleading and proving a compliance with it. These questions are not answered by the statement that it was a part of the duties of the contractor and that the contract being performed it will be presumed that it was lawfully performed and that there is no showing that the Kootenai

River is navigable, because no matter whose duty it was to comply with this provision in the first instance, the County certainly must be said to have taken this contract knowingly with this condition in it, and in the absence of allegations and proof it cannot contend that the contractor by fraud or imposition procured its acquiescence in the evasion of this provision. And next, as to the presumption that the permission was obtained because the contract was performed. Now, as a matter of fact there is nothing upon which to base a conclusion that the contract was lawfully performed. The construction of the bridge is one thing, and the performance of this contract another thing, and all that is shown by the record is that the bridge was constructed. Moreover, this very opinion itself holds that this bridge could have been constructed legally without obtaining the approval of any plans and specifications because there is no presumption of navigability and that no navigability is shown. The use of the two presumptions; that is, the one to the effect that the river is not navigable, and the other that the bridge was lawfully constructed, neutralizes and renders of no effect and inapplicable each of the presumptions.

If you strip this case down to its bare facts, you find a contract containing a condition precedent with no allegation of performance of it and with no proof of performance of it. It will not

do to answer this state of facts by saying that the trial judge held "that he considered the complaint amended to conform to the proof" for the obvious reason that there is no proof upon the question and if amended to conform to the proof the complaint will be just as silent as before the proof was written into it. Nothing is gained for the plaintiff from the fact that in the contract of February 5, 1912 (p. 8, transcript), the provision in question is not rewritten. A fair reading of the February 5th contract convinces that it is not presumed to be complete within itself because it contains no provision as to payment except by payment in addition to the original contract, contains no agreement as to the furnishing of any bond, contains no provision with regard to payment for trestle, additional concrete, contains no time of performance and does not provide who is to furnish the materials, etc., etc. In the opinion some mention is made of the fact that the answer does not affirmatively plead failure to obtain the approval of the plans and specifications. If this provision is valuable at all, it is that it is a condition precedent. There should be no uncertainty as to whether these provisions create a condition precedent. They distinctly, definitely and without equivocation state "that this contract shall not take effect," etc. For illustration, suppose that this contract had been executed, the bond given, no plans or

specifications approved by the War Department, and the contractor did nothing. Could a suit then be brought upon this contract against the surety? Manifestly not. If not, then what has changed the surety's rights? It cannot be that this Court is going to place the rights of the surety entirely in the hands of the principal in the bond. It is contrary to all theories of the law. There is no legal principle which can enlarge the obligations contained in the surety's contract. To hold the surety liable in this case because the bridge was actually erected not only places the Surety Company entirely in the hands of the principal, but it goes further and places the Surety's obligations in the hands of the obligee because obviously the Surety would not be liable under the reasoning of the opinion if the bridge had not been built, and the bridge was actually built by the Bridge Company with the concurrence of the County in such a way as that the bridge fell down.

It seems to us that presumptions having their basis on the fact that the work was constructed are entirely foreign to the determination of the contract obligations of the Surety. The Surety took no part in any construction. The Surety's contract provided that it was liable only if the plans and specifications were such as to gain the approval of the War Department. The intent as expressed in this provision and the words as ex-

pressed comply in every detail with the definition of conditions precedent.

In 4 Encyclopedae Pleading and Practice 627, it is said:

> "A condition precedent calls for the performance of some act, or the happening of some event, after the terms of the contract have been agreed upon, before the contract shall take effect; that is to say, the contract is made in form but does not become operative as a contract until some thing or act is performed before some subsequent event occurs."

And (p. 629):

> "The performance of a condition precedent to be executed by one other than the plaintiff must likewise be averred."

Apply these conceded rules to the case at bar. Here you have a surety upon a contract, which by its express terms is not to become effective until the plans and specifications have been approved. Plaintiff sues and absolutely ignores this condition, does not mention it, and when he comes to trial offers no proof concerning it. The fact that the Surety agreed to the contract containing this provision precludes any inquiry as to whether the Surety would have become bound in an agreement where the contractor was to be unrestrained and for a lump sum to put up such a bridge as the Bridge Company thought expedient. It is beside

the point to say that the engineers of the government might have allowed this particular bridge to have been built in a manner which would allow it to fall and obstruct the stream. Whether they would or not is not the inquiry. The inquiry is and it must be, whether the plaintiff has shown that a bridge built under plans and specifications approved by the War Department has collapsed to the damage of the plaintiff?

We could pile up authorities without limit to the effect that the words of this contract make it operative only when the specified event happens and to the effect that one who seeks to recover upon a contract must bring himself within it by pleading performance upon his own part and breach on the part of the other. No one disputes these principles and no one ever has in this case, but it does seem to us that the opinion does not meet these contentions and that the contentions are directly based upon the record.

ANTICIPATED PAYMENTS

In the opinion in the case it is held that under the law the Surety Company is required to show injury arising from the anticipated payments because of the fact that it is a compensated surety.

In **Prairie State Bank v. United States, 164 U. S. 227, 41 L. Ed. 412,** the following with regard to retaining payments is quoted with approval:

"And the effect of this stipulation was at

> the same time to urge Streather to perform the work and to leave in the hands of the company a fund wherewith to complete work if he did not and thus it materially tended to protect the surety."

Note that the advantages of the surety are twofold: First, that the retained percentage acts as a pressure upon the contractor to hold him in line and to properly perform, and second, to provide a fund in the event that the contractor does not perform. In this same case the Supreme Court of the United States quotes with approval the following:

> "The principle is, the withdrawal of the fund agreed upon as security for the performance of the contract without his consent is a prejudice to the surety of guarantor."

All of the decisions in point recognize this twofold purpose of the withholding of payments, and it is equally well established that the withdrawal of this fund by its payment prematurely to the contractor of itself prejudices the Surety; and this must be true because if you remove the pressure on the contractor to honestly carry out his work, you certainly thereby increase the risk of his surety. We venture the assertion that no case exists in the United States except this one in which any court has held that the surety was not released by substantial anticipated payments. It is true that

some authorities have held that a compensated surety must show injury, but all authorities to this date have agreed that the advance payments of itself is injury. If it be the law that a surety in addition to the conceded fact that the pressure is removed upon a contractor to honestly perform, must show that the contractor would have honestly performed if the payments had been withheld, then the surety must always pay no matter what the obligee does as to advance payment, if it be a case in which the work was carelessly performed. Of course, as to cases where the contractor fails entirely to perform and the surety must take up his labors, the difference in the amount of money on hand and what would have been on hand if the percentage had been retained will physically demonstrate the amount of damage to the surety; but in a case in which overpayments had been made to the contractor and the contractor has been careless in his work so that the structure falls, it must be apparent to everybody that the only way a surety can show further injury than the withdrawal of the pressure would be to prove that the contractor would not have been negligent if the pressure of his retained money had remained. Of course, everybody knows that a contractor who has not been paid feels a greater interest and stays more upon the work than a man who has all of his money and who has the unpleasant task of yet earning it in the future.

There is a distinction to be had in the authorities which we are trying to urge upon Your Honors to the effect that even if the compensated surety must show injury, still that he has shown it whenever the fact of substantial over-payment appears.

For the purpose of showing the flagrant violations of the duty of the County in this case, let us turn for a moment to the resolution which shows the spirit in which this payment was made. The resolution authorizing the anticipated payments itself recognizes that the County is shifting the burden from the contractor to the contractor's bondsman. It says (p. 89, Transcript):

> "Whereas the Coast Bridge Company has furnished good and sufficient bonds in the sum of $65,000.00 with the National Surety Company of New York, as surety conditioned for the performance of the terms and conditions of each of said contracts,"

What did the County have in mind when they passed that resolution? They are merely saying that while we have a right to hold the contractor in line and make him honestly perform by retaining his money, still we waive that right because if our judgment is wrong and the contractor does not honestly perform, then we will make his bondsman pay. Let it be accepted as the law, for the sake of argument, that the surety must show

an injury and increase of his risk. Can anybody fairly contend that this resolution does not deliberately withdraw the security fixed by the contract and place an additional burden upon the surety? And this established, the plaintiff contends that the contractor did not carry out the contract carefully but was careless. In other words, the very thing happened, according to the County, which the County anticipated when in its resolution it recited that it had a bond.

Although we have conceded to this point that it is established as the law that a compensated surety is not entitled to the benefit of the rule of **strictissimi juris**, we strongly contend that as yet the contrary is the law and that this Court is required to overrule the Supreme Court of the United States in holding an opposite view.

Let us consider the cases on the question:

Williams v. Pacific Sureties Company, 77 Ore. 210, 149 Pac. 524, involved a failure to complete a logging contract; no question of advanced payments in it. The case squarely holds that a compensated surety must show injury. **Leiter v. Dwyer Plumbing Co., 66 Ore. 474, 133 Pac. 1180,** involved the total abandonment on the part of a subcontractor to do plumbing; no question of payments in it. The author of this petition wrote the brief on behalf of Leiter in that case and hence knows that it does squarely hold that a compensated surety must show damage. **Manhattan Com-**

pany v. United States Fidelity & Guaranty Company, 77 Wash. 405, 137 Pac. 1003, appears to involve over-payments to contractor, but it develops that the payments were not made to the contractor but were made to workmen whom the contractor had employed and for the purpose of preventing the filing of a lien. Also, although the payments made to the contractor exceed by $100.00 the contract rates, still $115.00 of extra work had been done. The case cites with approval a previous case in Washington to the effect that an advanced payment of $3500.00 upon a total contract of $16,500.00 would release the surety. In the case at bar it is a fact and the opinion recites:

> "One-half of the contract price was paid in advance of the arrival of any of the materials or the performance of any work."

The contract provides (p. 64, Abstract) for a total payment of $24,252.00 and the first 25 per cent thereof upon the completion of the concrete piers. Under the established law in Washington this would release the surety.

This disposes of all the State Court decisions urged as supporting the opinion.

In **Lonergan v. San Antonio Trust Company, 101 Tex. 63,** Washington cases are discussed and the Texas Supreme Court refuses to follow them. It is said:

> "How it could be that receiving compensa-

tion by the surety would affect the relation between the surety on the bond and the owner of the building has not been suggested by counsel, and is not apparent to us."

No distinction as to compensated surety has been made in many States.

Alcatraz v. United States Fidelity & Guaranty Co., —Cal.—, 85 Pac. 156.

Norwegian v. United States Fidelity & Guaranty Co., 83 Minn. 269, 86 N. W. 330.

Burns Estate v. Fidelity & Deposit Co., —Mo.—, 70 S. W. 518.

House v. American Surety Co., —Tex.—, 54 S. W. 303.

The cases in the Federal Courts, in our humble judgment, do not sustain the opinion in this case but on the contrary leave the old rule in force as to cases like the one at bar.

In **Atlantic Trust & Deposit Co. v. Town of Laurinburg, 163 Fed. 690,** the Circuit Court of Appeals of 4th Circuit decides a case of anticipated payments exactly as the one in the case at bar. As far as we have been able to learn this is the only case where a Federal Court has held that anticipated payments does not in and of itself show damage to the surety. It is based upon **United States Fidelity & Guaranty Co. v. U. S., 191 U. S. 416, 48 L. Ed. 242,** and it rests upon the erroneous assumption that the Supreme Court in that case departed

from the established rules with regard to sureties. A reference to the basic case shows that what the Supreme Court of the United States actually decided was that in a contract given nominally to the Government but really for the benefit of third persons and covering an indefinite obligation would not be construed as strict as bonds given for the indemnity of the obligee. It is true that in the opinion it is said (of the rule of **strictissimi juris**):

> "It is one which ought not to be extended to contracts not within the reason of the rule, particularly when the bond is underwritten by a corporation which has undertaken for a profit to insure the obligee against a failure of performance on the part of the principal obligor."

The case involved an extension of time granted by a person furnishing materials to the contractor. The extension was granted for sixty days. This the Court held not to be an unreasonable time and to really be within the time which the Surety Company should have contemplated when it gave the bond. The opinion then says:

> "Such a contract should be interpreted liberally in favor of the sub-contractor with a view of furthering the beneficent object of the statute."

This quotation gives the essence of what the Supreme Court decided, and they squarely base

their holding upon a particular statute under which the bond was given. The opinion justifies the statement that it is intended therein to denote a clear distinction as to the law which would be applied in the event that the bond had been an indemnity for the United States, and for definite obligations. It is also said in the opinion:

> "In an ordinary guaranty the guarantor understands perfectly the nature and extent of his obligation. If he becomes surety for the performance of a building contract, he is presumed to know the parties, the terms of their undertaking, the extent and feasibility of the work to be done, the character and responsibility of the principal obligor, and his ability to carry out the contract."

This clearly shows that the Court is not changing the law with regard to sureties for compensation upon construction contracts. The fact that the Supreme Court of the United States is not changing the law is conclusively shown by the following quotation from the opinion:

> "Counsel for the brick company argued with much persuasiveness that this rule of **strictissimi juris,** though universally accepted as applicable to the undertaking of an ordinary guarantor, who is usually moved to lend his signature by motives of friendship or expectation of reciprocity, and without pecuniary consideration, has no application to the

guaranty companies, recently created, which undertake, upon the payment of a stipulated compensation, and as a strictly business enterprise, to indemnify or insure the obligee in the bond against any failure of the obligor to perform his contract. **It is, at least, open to doubt, however, whether any relaxation of the rule should be permitted as between the obligee and the guarantor,** which may have signed the guaranty in reliance upon the rule of **strictissimi juris,** and with the understanding that it is entitled to the ordinary protection accorded to guarantors against changes in the contract or extensions of the time of payment."

It is apparent that the Court here expressly says that it is open to doubt whether there should be any relaxation of the rule as between the obligee and the guarantor because of the fact of compensation of the surety. This statement is inconsistent with the claim that the Court did intend to make such a change in the law in that opinion. The Supreme Court, it seems to us, in the following quotation expressly limited the decision to bonds given to cover uncertain obligations which may later occur in favor of third parties, that is:

"The question involved is whether the ordinary rule that exonerates the guarantor in case the time fixed for the performance of the contract by the principal be extended applies

> to a bond of this kind, executed by a guaranty company not only for a faithful performance of the original contract, but for the payment of the debts of the principal obligor to third parties."

That the Supreme Court of the United States does not understand that it has relaxed the rule in any cases other than where bonds were given in pursuance of the statutes for the benefit of the third parties, is definitely shown in the very late case of **Equitable Surety Co. v. United States of America, to the use of W. McMillan & Son, 234 U. S. 448, 58 L. Ed. 1394.** The case involved an action against a compensated surety to recover for work and labor furnished by third persons. It is held in the opinion that changes made by the Government will not work a release of the surety so far as claims in favor of third persons are concerned. It is expressly stated, however, that as to the Government a distinction exists and any departure had from the terms of the contract will release the surety even though the change "be beneficial to the principal obligor." It is there said:

> "The rule that obtains in ordinary cases is that any change in the contract made between the principals without the consent of the surety discharges the obligation of the latter, even though the change be beneficial to the principal obligor.

But it lies at the foundation of this rule of **strictissimi juris** that the agreement altering the undertaking of the principal must be participated in by the obligee or creditor, in order that it may have the effect of discharging the surety. This is expressed or implied in all the cases. Miller v. Stewart, 9 Wheat, 680, 703, 708, 709, 6 L. ed. 189, 195-197; Sprigg v. Bank of Mt. Pleasant, 14 Pet. 201, 208, 10 L. ed. 419, 422; Magee v. Manhattan L. Ins. Co., 92 U. S. 93, 98, 23 L. ed. 699, 700; Union Mut. Ins. Co. v. Hanford, 143 U. S. 187, 191, 36 L. ed. 118, 120, 12 Sup. Ct. Rep. 437; Prairie State Nat. Bank v. United States, 164 U. S. 227, 233, 41 L. ed. 412, 416, 17 Sup. Ct. Rep. 142; United States v. Freel, 186 U. S. 309, 310, 317, 46 L. ed. 1177, 1178, 1181, 22 Sup. Ct. Rep. 875.

In the case of a bond given under a statute such as the act of February 28, 1899, there is no single obligee or creditor. The surety is charged with notice that he is entering into what is, in a very proper sense, a public obligation, and one that will be relied upon by persons who can in no manner control the conduct of the nominal obligee, and with respect to whom the latter is a mere trustee, and therefore incapable, upon general principles of equity, of bartering away, for its own benefit or convenience, the rights of the benefi-

ciaries. In the light of the statute, the surety becomes bound for the performance of the work by the principal in accordance with the stipulations of the contract, and for the prompt payment of the sums due to all persons supplying labor and material in the prosecution of the work provided for in the contract.

What would be the result of a change not contemplated in the original contract, as between the District of Columbia, consenting to the change, and the surety company, not consenting thereto, is a question not now before us, and respecting which we express no opinion."

While this opinion refers to changes made by the Government, yet the rule which it affirms as being the law indicates very clearly that it is the opinion of the Supreme Court that it has not yet given any basis for a Federal Court to hold that the Supreme Court has made a distinction between non-compensated and compensated sureties except as applied to a bond given for the protection of third persons. It also to us indicates very clearly that the Supreme Court of the United States in rendering this decision were fully cognizant of the contention that a change should be made in the law as to compensated sureties. It is likewise just as clear to us that the Court in this opinion is in-

dicating that when that question is presented to the Court that it is considered very doubtful that the Court will decide to change the law. A reading of the report of the case shows that the authorities where it is claimed the distinction is made were in a large part before the Court and with that situation the Court says that the rule in ordinary cases is that any change even though beneficial to the surety's principal releases the surety. With this view of the law in the Supreme Court of the United States, the decision by the Court of Appeals of the Fourth Circuit in the Atlantic Trust-Laurinburg case is robbed of its support in Federal law and it stands alone and as we shall attempt to show in this brief in conflict with the weight of authority.

All of the other cases in Federal courts put forth as sustaining that a change has been made in the law, are from Pennsylvania with the exception of Guaranty Company v. Pressed Brick Co., 191 U. S. 416. That case is the same one which has been referred to as the basis of the Atlantic Trust-Laurinburg case and we make no further comment upon it.

Let us now take up the Federal cases from Pennsylvania. The first one was **Baglin v. Title Guarantee & Surety Co., 166 Fed. 356, affirmed, 178 Fed. 682.** At the outset it should be carefully noted that it is not a construction case at all but

involved the return of certain securities. That part of the decision which treats of compensated sureties is purely dictum, and it is said of the contention with regard to a claimed extension of time (166 Fed. p. 363):

> "Whatever force might be allowed to this contention, if the defendant had guaranteed the payment of the note—a point that does not need consideration now—I think no weight should be given it, if I am right in the construction I have put upon the defendant's obligation."

The dictum is then based upon the Guaranty Co. v. Pressed Brick Co. in 191 U. S., and the decision of the Fourth Circuit in Atlantic Trust v. Laurinburg, both of which cases give no support to the doctrine that the law has been changed in Federal jurisdiction according to our analysis of them. The Atlantic Trust-Laurinburg case is based upon the Guaranty Co.-Pressed Brick case, and the Guaranty Co.-Pressed Brick case does not hold what the Atlantic Trust Co.-Laurinburg case claims for it. The decision in the Baglin-Title Guarantee case upon appeal to the Circuit Court of Appeals does not sustain the dictum of the Court below because in the entire opinion the Circuit Court of Appeals very carefully refrains from placing any part of their decision upon the ground of a change in the law as to compensated

sureties. The Baglin-Title Guaranty & Surety Co. cases, that is in the court below and upon appeal are not authority in this case for the reason: First, that they did not involve the removal of the pressure upon the contractor engaged in construction by anticipated payments; second, any reference to a change in the law by the lower court is dictum and based upon an erroneous conception of the Guaranty Company-Pressed Brick decision in the United States Supreme Court; third, the Circuit Court of Appeals very carefully strips the decision of any holding upon the question of compensated sureties.

In the case of **Justice v. Empire State Surety Co., 209 Fed. 105,** Judge Thompson, sitting in the District Court of the Eastern District of Pennsylvania, judicially determines that the Trust Co. v. Baglin cases and the Guaranty Co. v. Pressed Brick Co. case do not change the rule as applied to anticipated payments made to a construction contractor. The case involves squarely the question of whether or not by anticipated payments the surety was released and after a citation and analysis of the cases, Judge Thompson says:

> "After a somewhat careful examination of the cases, I have been unable to find any case in which the relaxation of the rule of **strictissimi juris** was extended as between the surety and the obligee in the bond to the extent of requiring proof of actual injury in the case

> of breach of the terms of the bond by anticipation of payments by the obligee to the contractor. In such case, for the reasons stated in Prairie State Bank v. United States and Fidelity Co. v. Agnew, and upon the authorities there cited, anticipation of payments by the obligee is held as a matter of law to be a material variance from the terms of the contract."

We urge upon Your Honors that Judge Thompson's decision states the law. Concededly there have been cases which hold that damage must be shown in order that a compensated surety may be relieved but the theory of all the cases is that an anticipation of payments by the obligee as a matter of law shows damage. It might be that where the anticipated payment was very small that the Court would not be justified as a matter of law in holding this, but where as in the case at bar, the payment before any work is commenced at all is substantially half of the total contract price and before the piers are completed substantially half of the remainder, and the contract providing that no payment be made until the piers are completed, it seems to us that no Court should hesitate in saying that as a matter of law the pressure upon the contractor to carry out his contract is dissipated and the surety is thereby injured.

Another Pennsylvania Federal case urged as supporting the opinion is **United States Fidelity &**

Guaranty Co. v. United States, 178 Fed. 692. This decision is likewise prior to Judge Thompson's analysis of the authorities contained in the 209 Federal. The case is also distinguishable at a mere glance at the syllabus, as it appears to be a case brought to recover for labor and materials furnished, upon a bond given for the benefit of third persons under the statute considered in Guaranty Co. v. Pressed Brick Co., 191 U. S. A distinction as to the Guaranty Co.-Pressed Brick Co. case also distinguishes this case. The Justice-Empire State Surety case was reviewed by the Circuit Court of Appeals of the Third Circuit and is reported in 218 Fed. 802. It is there upon that appeal directly held that the anticipation of payments, although only in the sum of $2,000.00 as against a contract price of $11,700.00, released the surety; and the case of Prairie State Bank v. United States, 164 U. S. 233, 41 L. ed. 412, is cited with approval, and also with approval from the Prairie State Bank v. United States case is taken the quotation from Holme v. Brunskill, 3 Q. B. D. 495, as follows:

> " * * * * That if it is not self-evident that the alteration is unsubstantial, or one which cannot be prejudicial to the surety, the court will not, in an action against the surety, go into an inquiry as to the effect of the alteration, or allow the question, whether the surety is discharged or not, to be determined by

the finding of a jury as to the materiality of the alteration, or on the question whether it is to the prejudice of the surety, but will hold that in such a case the surety himself must be the sole judge whether or not he will consent to remain liable, notwithstanding the alteration, and that, if he has not so consented, he will be discharged."

The opinion certainly takes from the Baglin-Title Guaranty cases and as well as all cases previous to its date any claim of support for the doctrine that anticipated payments do not of themselves release the surety. It is squarely so held in the following language:

"Moreover, the advancements are so large and substantial that it may be accepted as self-evident that the alteration by the plaintiff proved prejudicial to the surety, if such showing should be deemed important. There was, therefore, nothing to leave to the jury, and we think the judge below was right in giving binding instructions, and holding, as he did, that:

'For the reasons stated in Prairie State Bank v. United States and Fidelity Co. v. Agnew, and upon the authorities there cited, anticipation of payments by the obligee is held as a matter of law to be a material variation from the terms of the contract."

In **Wells v. National Surety Co., 222 Fed. 8,** the Circuit Court of Appeals of the Third Circuit approved the Justice-Empire State case and again held under date of April 17, 1915, that anticipated payments made to a contractor released the compensated surety, and it is said:

> "Having acquired $4,000 by this means before any payments were due under the contract, and having performed work under the contract for which it thereafter received but $875 out of a contract price of $11,847, the Contracting Company quit work on May 4th, leaving the principal contractor to complete its work and the defendant Surety Company to pay for it. May it not be said that, when the subcontractor became possessed of $4,000 in advance of work done and payments due, he lost an incentive to continue, and the Surety Company was deprived of the protection which such incentive normally assures?"

Your Honors will note that again the loss of incentive to continue is as a matter of law held to be an injury to the surety. It seems to us that there should be no hesitancy in declaring that the removal of the incentive to the contractor to honestly and faithfully and diligently perform by paying him as much as he will receive no matter what he does works an injury upon the surety. As far as the contractor is concerned, where his payments

are anticipated, he will get the same amount of money if he carelessly and indifferently performs as if he carefully and diligently performs.

The remaining Federal case urged in support of the opinion, that of **American Bonding Co. v. United States, 233 Fed. 364,** is from the Third Circuit. It like the Guaranty Co.-Pressed Brick Co. case was by one who furnished services and material and the suit was upon a bond given in pursuance of the Federal statute. This would distinguish it as to any case having application here. The case, however, does hold that the anticipated payments of themselves released the surety. It is said in the opinion:

> "We need scarcely discuss the proposition that such a course of dealing materially changed the terms of payment originally agreed upon and guaranteed. These terms were not observed at all, and it is not sufficient to reply that Wells was hampered by insufficient capital, and by the fact that he was carrying on other contracts at the same time and was compelled to use the money for other purposes. Neither is the reply sufficient that the Marble Company could not induce Wells to pay in accordance with the subcontract, and was therefore obliged to accept the notes and such money as it could get, because this was the best way out of the diffi-

culty. The company certainly owed some duty to the surety. It was not obliged to go on with a contract that Wells from the first was refusing to carry out, and if it chose to do so, and to take its chance of getting out whole, it must stand by the risk it deliberately undertook. We do not know whether the Bonding Company knew the terms of the agreement between Wells and the Marble Company; but in any event it does not appear to have had knowledge of what the parties to the agreement were actually doing, and it had a clear right to rest on the assumption that (whatever the terms of payment might be under the subcontract) they would be lived up to without material change, and without injury to itself. In brief, a corporate surety under the act of 1905 is much like the signer of a blank check. Undoubtedly such a man takes a risk; if a larger sum should be inserted than he intended, he must usually accept the situation; but, after the blank has been filled, his liability is fixed, and is not subject to injurious change thereafter."

The case, far from being an authority to the effect that anticipated payments will not release the surety, argues directly that such payments constitute an injury and damage to the surety. The case also argues that one making the advanced

payments thereby assumes a risk by the removal of pressure on the contractor and that that risk cannot be made to fall upon the surety. While the case is not in point in view of the fact that the bond was given for the payment of uncertain obligations to third parties, still so far as it is applicable it seems to us to argue directly that the making of anticipated payments of itself results in an injury to the surety. It is true in the case that the amount of funds retained had a direct bearing on the amount which the surety was to pay, but remembering that the purpose of the retaining payments was two-fold: First, to keep pressure on the contractor that he will honestly perform; second, to indemnify the surety in the event that he failed to perform, there is and should be no distinction in principle where the contractor fails to perform and where he negligently performs. In any event his conduct is directly participated in by the obligee by the removal of the pressure calculated to hold him in line.

This concludes the discussion upon the Federal cases supporting the opinion, and it is seen that the decision in the Fourth Circuit, which still stands, is based upon the Guaranty Co.-Pressed Brick decision in the United States Supreme Court, and that the Guaranty Co.-Pressed Brick case does not establish any change in the law as to anticipated payments on the part of the Supreme Court of the United States; and so far as the other Federal

cases are concerned all arising in Pennsylvania, it is established to be the settled law in Pennsylvania that an anticipated payment made to a contractor releases the surety where the bond is given not for the benefit of third persons but directly to the owner of the structure.

Another principle which we take it must be said to be established by the authorities is that no matter if the surety is required to show damage that he shows it as a matter of law when he shows that by the anticipated payments the pressure on the contractor has been removed. This conclusion renders unnecessary an analysis of the statutes of Montana because it is conceded that under these statutes all that need be shown is that the surety be damaged. Now, if the anticipated payments as a matter of law shows damage to the surety then under the Montana statutes the surety is discharged. However, an analysis of the Montana statutes gets to the same place. In the opinion it is said:

> "We think, however, that the second and third sections of section 5686 are controlling and that such is the effect of the decision of the Supreme Court of Montana in the case above cited."

In accordance with the view of the Court as to the sections applicable, we call attention to the language of those sections. They are:

> "A surety is exonerated:
> 1. * * * *

2. To the extent to which he is prejudiced by any act of the creditor which would naturally prove injurious to the remedies of the surety or inconsistent with his rights, or which lessens his security; or

3. To the extent to which he is prejudiced by an omission of the creditor to do anything, when required by the surety, which it is his duty to do."

Of these two sections number 2 must be the one which is applied, and under that section nothing is said about any indemnity. The feature of indemnity we will discuss a little later in this brief, but under this subdivision 2 the language leaves no room for any intention of a condition with regard to indemnity. Section numbered 1 is complete and section numbered 2 is likewise complete within itself so that the surety is exonerated if any act of the creditor naturally proves injurious to his rights or is inconsistent with his rights. Applying the rule of the cases to the effect that anticipated payments removes the pressure upon the contractor to cause him to diligently perform and is an injury to the surety, the answer is plain because it is then shown that the creditor, to wit, the County, has been guilty of acts inconsistent with the rights of the Surety, which are injurious to the Surety. The effect of these acts can logically be found only by taking what actually happens and you find that the contractor, according to the conten-

tion of the County, was negligent, and you find that his negligence occurred after the County had removed from him the stimulus and incentive to honestly perform by paying him all he would receive in any event. This being true and it being impossible to prove what the contractor would have done if the inducement to faithfully perform had not been removed, it would seem to be established that injury was as well shown as it could be in any case and to be a sufficient showing to release the Surety under the laws of Montana. While under this section of the statute a question of indemnity is not involved, yet because there is a reference to an offer of proof made upon the trial and to a letter which was introduced, we wish to challenge Your Honors' attention to the fact that this letter will not sustain a contention, if construed most strongly against the company, of anything beyond the fact that the Coast Bridge Company is bound to indemnify National Surety Company. That is what the letter says and obviously all it means. This leaves the matter exactly where it would be if the letter had not been written because it is the law that a principal must indemnify a surety if the surety is compelled to pay a loss because of defaults on the part of the principal. With regard to the offer of proof. The offer is to prove that Coast Bridge Company has agreed to indemnify National Surety Company. Proof of that kind is clearly incompetent and goes to a fact

about which there can be no dispute. The law undoubtedly is, without regard to any statute, that the principal is liable to the surety and must indemnify the surety. In addition, Section 5690 of revised codes of Montana for 1907 provides:

> "If a surety satisfies the principal obligation, or any part thereof, whether with or without legal proceedings, the principal is bound to reimburse what he has disbursed, including necessary costs and expenses; but the surety has no claim for reimbursement against other persons, though they may have been benefited by his act, except as prescribed by the next section."

The next section provides for the subrogation of the surety to the rights of the obligee. The law is perfectly clear under the statutes of Montana that a surety indemnified only by his principal is released by an act of the creditor injurious to the surety. That offer of proof carried with it nothing beyond that which was contemplated by the statutes and the law and which did not change either the statutes or the decisions.

There should be no confusion with regard to section 5673 of the Codes of Montana, because in the first place it cannot be read into subdivision numbered 2 of section 5686, and furthermore section 5673 contemplates as indemnity something more than the mere liability of the principal in the

bond to indemnify the surety, because otherwise the section 5673 is meaningless, as under the law the principal always is bound to indemnify the surety. A reading of the Codes of Montana as to guarantors and sureties will convince that the indemnity which will prevent the release of a guarantor must be something more than the mere indemnity furnished by the relation of principal to surety. However, it seems to us that the application of subdivision 2 of section 5686 eliminates in this case any question of indemnity.

CHANGE OF CENTER PIER

With regard to the change of the center pier. What we claim for this is that it shows that in this very important particular the bridge as constructed was not constructed according to plans and specifications previously approved by the War Department. Heretofore in this petition we discussed this provision of the contract and the fact that there was no allegation or proof on the part of the plaintiff of a compliance therewith, but with regard to the construction of this center pier and the place of its location the record shows (p. 105, transcript) that when this pier was moved that there was no change made in the plan which demonstrates that there was no approval of the location of this pier on the part of the engineers of the War Department because if the plan was not changed, manifestly the plan as changed could not

be put up to the War Department. Bear in mind that the original contract provided that it should not become operative until the plans and specifications had been approved by the War Department. It seems to us that this testimony with regard to the change of the center pier demonstrates not only that the plan in this regard was not put up to the War Department but that the pier was placed in a more dangerous position than the plans originally drawn and if the presumption is to be indulged that the original plans were approved by the War Department, then it is shown that the County knowingly allowed the construction of this important part of the bridge contrary to the plans approved by the War Department. This testimony standing admitted in the record is entirely competent under the general denials of the answer because the burden of proving a compliance with the contract is upon the plaintiff. No special allegation was necessary in order for the defendant to show that the bridge had been constructed without the approval of the War Department and here is a particular in which it is demonstrated that this actually occurred. Moreover according to the testimony of McClayn, which is undisputed, this center pier was placed where the water would have a bigger sweep at it than as shown by the plan. This fact was set out in the opinion. If the water swirling around had a bigger sweep at the pier, this must be said to establish a location where it would

be more difficult for the pier not only to be constructed but to remain. The claim of the County here is that the water undermined the pier. Now, if the pier was placed where there was a bigger sweep of the water, it seems to us that everybody must concede that the bigger the sweep the more damage the water would do, so that you have a situation in which the plan for the pier, which is a very important part of the bridge, could not have been approved and where the pier which actually went out was placed in a more dangerous position than shown by any plan which could have been approved. It is said in the opinion in this case that the failure might have been made at the instance of the contractor. We contend that it would make no difference who urged the program for the removal of the protections to the Surety—that the Surety Company had a contract which rendered it liable only for work done in pursuance of plans previously approved by the War Department, and if the County knowingly accepted in performance of this contract work which was performed not in accordance with a plan previously prepared, that the accepted work which under the plain English language written in our contract cannot be said to be within the contract which we guaranteed. It is also said in the opinion that the lower court may have found that the change as to the center pier was an alteration permissible under

the terms of the contract. We contend that what the lower court may or may not have found would not in any wise bind this court, as we are applying to this court for the purpose of having the law correctly applied to the record, and what alterations are permissible under this contract is purely a question of law, where the alteration made is indisputably established. However, we do not urge the alteration as being one which of itself would work a release so much as we urge that it demonstrates that the County knowingly allowed the construction of a bridge which was not within any plans and specifications previously approved by the War Department.

CONCLUSION

There are other respects in which our humble judgment will not allow us to view the law to be as it is set out in this opinion, but in those respects we defer to the superior knowledge of Your Honors, and we urge the foregoing only because we are so convinced of them as that we think Your Honors could in justice allow us to be heard further upon them. The contention with regard to the approval of the plans and specifications involves no new principle of law and under the authorities we cannot convince ourselves but that plaintiff must plead and prove a compliance with this contract in order to make a case.

With regard to the payments which are devel-

oped by the plaintiff's case to have been made out of order. We have been unable to find a single authority which has gone so far as the opinion in this case goes, and such law as we have been able to find is directly contrary to the position taken in the opinion. We make bold to suggest to Your Honors that if there is to be a change in the Federal jurisdiction of the law with regard to the anticipation of payments that the Supreme Court of the United States take the responsibility of making it. The Supreme Court of the United States when it decided the Equitable Surety v. United States case on June 8, 1914, knew about the tendency of some of the courts to relax the rule of **strictissimi juris,** but the Supreme Court of the United States in that case advisedly states the rule and makes no relaxation as to a compensated surety. No opinion of any Circuit Court of Appeals, which we have been able to find, has carried the doctrine announced in the case at bar, and no other opinion of a Circuit Court of Appeals, that we have been able to find, supports it.

A reversal of this case would not necessarily mean that plaintiff could not eventually recover. The plaintiff has a cause of action against the Bridge Company and another against the Surety Company if the facts be as the plaintiff claims. The plaintiff advisedly elected to prosecute an action solely against the Surety Company. The plaint-

iff should not be allowed to prosecute an action solely against the Surety Company and have applied the rules of law which would apply if the action was against the Bridge Company. In other words, the plaintiff can yet, if it is so advised, maintain an action against the Bridge Company if it be that the County honestly believes that the Bridge Company is able to indemnify the Surety Company, because if the Bridge Company is financially able to indemnify the Surety Company, then, of course, it is financially able to pay a judgment which the County might obtain against it.

We respectfully submit to Your Honors that a rehearing should be granted in the case, and if the state of the law is as we contend for it that either the case should be reversed, or the Supreme Court of the United States on certificate or by writ of certiorari allowed to settle the law upon the question.

Respectfully submitted,

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Dated January 24, 1917.